

## Management's Responsibility for Financial Reporting

The consolidated financial statements, management's discussion and analysis (MD&A) and all financial information contained in the annual report are the responsibility of management. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and, where appropriate, have incorporated estimates based on the best judgment of management.

To discharge its responsibility for financial reporting, management is responsible for implementing and maintaining adequate internal controls to provide reasonable assurance that the Company's assets are safeguarded, that transactions are properly authorized and that reliable financial information is relevant, accurate and available on a timely basis.

The consolidated financial statements have been examined by PricewaterhouseCoopers LLP, the Company's external auditors. The external auditors are responsible for examining the consolidated financial statements and expressing their opinion on the fairness of the financial statements in accordance with International Financial Reporting Standards. The auditor's report outlines the scope of their audit examination and states their opinion.

The Board of Directors, through the Audit Committee, is responsible for ensuring management fulfills its responsibilities for financial reporting and internal controls. The Audit Committee is comprised of three financially literate and independent directors. This committee meets regularly with management and the external auditors to review significant accounting, financial reporting and internal control matters. PricewaterhouseCoopers LLP have unrestricted access to the Audit Committee with and without the presence of management. The Audit Committee reviews the financial statements, the auditor's report, and MD&A and submits its report to the Board of Directors for formal approval. The Audit Committee is also responsible for reviewing and recommending the annual appointment of external auditors and approving the external audit plan. These consolidated financial statements and Management's Discussion and Analysis have been approved by the Board of Directors for inclusion in the Annual Report based on the review and recommendation of the Audit Committee.



Darin Rayburn  
Chief Executive Officer



Naomi Stefura, CA  
Chief Financial Officer

Edmonton, Alberta  
March 13, 2019



## *Independent auditor's report*

To the Shareholders of Melcor Developments Ltd.

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### *Our opinion*

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Melcor Developments Ltd. and its subsidiaries (together, the Company) as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

#### **What we have audited**

The Company's consolidated financial statements comprise:

- the consolidated statements of income for the years ended December 31, 2018 and 2017;
- the consolidated statements of comprehensive income for the years ended December 31, 2018 and 2017;
- the consolidated statements of financial position as at December 31, 2018 and 2017;
- the consolidated statements of changes in equity for the years ended December 31, 2018 and 2017;
- the consolidated statements of cash flows for the years ended December 31, 2018 and 2017; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

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### *Basis for opinion*

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### **Independence**

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

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### *Other information*

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report.

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*PricewaterhouseCoopers LLP*  
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Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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*Responsibilities of management and those charged with governance for the consolidated financial statements*

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

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*Auditor's responsibilities for the audit of the consolidated financial statements*

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Gordon R. Keiller.

**(Signed) "PricewaterhouseCoopers LLP"**

Chartered Professional Accountants  
Edmonton, Alberta  
March 13, 2019

## CONSOLIDATED STATEMENT OF INCOME

For the years ended December 31

(\$000s)	2018	2017
Revenue (note 22)	267,434	257,950
Cost of sales (note 22)	(142,223)	(141,142)
Gross profit	125,211	116,808
General and administrative expense (note 22)	(23,429)	(25,353)
Fair value adjustment on investment properties (note 11, 22 and 29)	863	(8,828)
Adjustments related to REIT units (note 26)	3,438	(8,085)
Gain on sale of assets	6	17
Operating earnings	106,089	74,559
Interest income	1,291	1,129
Foreign exchange gain (loss)	429	(591)
Finance costs (note 21)	(24,568)	(21,412)
Net finance costs	(22,848)	(20,874)
Income before income taxes	83,241	53,685
Income tax expense (note 23)	(18,968)	(15,160)
Net income for the year	64,273	38,525
Earnings per share attributable to Melcor's shareholders (note 18):		
Basic earnings per share	1.92	1.15
Diluted earnings per share	1.92	1.15

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the years ended December 31

(\$000s)	2018	2017
Net income for the year	64,273	38,525
Other comprehensive income		
Items that may be reclassified subsequently to net income:		
Currency translation differences (note 19)	12,181	(8,242)
Comprehensive income	76,454	30,283

See accompanying notes to the consolidated financial statements.

On behalf of Melcor's Board of Directors:



**Gordon Clanachan**  
Audit Committee Chair



**Timothy Melton**  
Chairman

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(\$000s)	2018	2017
<b>ASSETS</b>		
Cash and cash equivalents	26,727	42,505
Restricted cash (note 3D)	—	16,956
Accounts receivable	10,849	17,384
Income taxes recoverable	—	8,933
Agreements receivable (note 9)	126,490	129,949
Land inventory (note 10)	758,940	729,300
Investment properties (note 11 and 29)	1,032,687	975,856
Property and equipment (note 12)	14,020	14,658
Other assets (note 13)	53,363	48,710
Asset held for sale (note 8 and 29)	—	6,732
	<b>2,023,076</b>	<b>1,990,983</b>
<b>LIABILITIES</b>		
Accounts payable and accrued liabilities (note 14)	44,825	51,979
Income taxes payable	8,605	—
Provision for land development costs (note 15)	77,658	87,139
General debt (note 16)	659,556	658,258
Deferred income tax liabilities (note 23)	66,493	69,826
REIT units (note 26 and 29)	98,374	94,898
Subscription receipts (note 26)	—	16,623
Liability held for sale (note 8 and 29)	—	3,670
	<b>955,511</b>	<b>982,393</b>
<b>SHAREHOLDERS' EQUITY</b>		
Equity attributable to Melcor's shareholders		
Share capital (note 17A)	72,821	72,729
Contributed surplus	3,366	2,939
Accumulated other comprehensive income (AOCI) (note 19)	29,129	16,948
Retained earnings	962,249	915,974
	<b>1,067,565</b>	<b>1,008,590</b>
	<b>2,023,076</b>	<b>1,990,983</b>

See accompanying notes to the consolidated financial statements.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(\$000s)	Equity attributable to Melcor's shareholders				
	Share Capital	Contributed Surplus	AOCI	Retained Earnings	Total Equity
<b>Balance at January 1, 2018</b>	72,729	2,939	16,948	915,974	1,008,590
Net income for the year	—	—	—	64,273	64,273
Cumulative translation adjustment (note 19)	—	—	12,181	—	12,181
<b>Transactions with equity holders</b>					
Dividends	—	—	—	(17,362)	(17,362)
Share repurchase (note 17A)	(125)	—	—	(636)	(761)
Employee share based compensation					
Value of services recognized	—	450	—	—	450
Share issuance	217	(23)	—	—	194
<b>Balance at December 31, 2018</b>	72,821	3,366	29,129	962,249	1,067,565

(\$000s)	Equity attributable to Melcor's shareholders				
	Share Capital	Contributed Surplus	AOCI	Retained Earnings	Total Equity
<b>Balance at January 1, 2017</b>	72,137	2,594	25,190	894,800	994,721
Net income for the year	—	—	—	38,525	38,525
Cumulative translation adjustment (note 19)	—	—	(8,242)	—	(8,242)
<b>Transactions with equity holders</b>					
Dividends	—	—	—	(17,351)	(17,351)
Employee share based compensation					
Value of services recognized	—	408	—	—	408
Share issuance	592	(63)	—	—	529
<b>Balance at December 31, 2017</b>	72,729	2,939	16,948	915,974	1,008,590

See accompanying notes to the consolidated financial statements.

# CONSOLIDATED STATEMENT OF CASH FLOWS

<i>For the years ended December 31 (\$000s)</i>	2018	2017
<b>CASH FLOWS FROM (USED IN)</b>		
<b>OPERATING ACTIVITIES</b>		
Net income for the year	64,273	38,525
Non cash items:		
Amortization of tenant incentives (note 13)	6,710	6,304
Depreciation of property and equipment (note 12 and 22)	1,417	1,436
Stock based compensation expense (note 17g and 22)	450	408
Non cash financing costs	1,466	414
Straight-line rent adjustment	(2,054)	(1,446)
Fair value adjustment on investment properties (note 11, 22 and 29)	(863)	8,828
Fair value adjustment on REIT units (note 26 and 29)	(13,827)	558
Gain on sale of assets	(6)	(17)
Deferred income taxes (note 23)	(3,493)	2,565
Cash provided by operating activities before changes in non-cash working capital	54,073	57,575
Agreements receivable	3,459	(13,705)
Development activities (note 3u)	(22,636)	1,149
Payment of tenant incentives and direct leasing costs	(8,279)	(5,944)
Purchase of land inventory (note 10)	(7,821)	(42,579)
Operating assets and liabilities (note 3U)	12,031	10,910
	30,827	7,406
<b>INVESTING ACTIVITIES</b>		
Purchase of investment properties (note 11)	(33,541)	—
Additions to investment properties (note 11)	(21,417)	(36,150)
Net proceeds from disposal of investment properties (note 11)	516	7,379
Net proceeds from disposal of asset held for sale (note 8 and 11)	16,389	—
Purchase of property and equipment (note 12)	(798)	(625)
Proceeds from disposal of assets	25	55
	(38,826)	(29,341)
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of trust units (note 26)	17,302	—
Net proceeds from issuing convertible debenture (note 16F)	—	21,543
Revolving credit facilities	(30,000)	26,477
Proceeds from general debt	128,236	56,774
Repayment of general debt	(106,518)	(61,278)
Dividends paid	(17,362)	(17,351)
Common shares repurchased (note 17A)	(761)	—
Share capital issued	194	529
	(8,909)	26,694
<b>FOREIGN EXCHANGE GAIN (LOSS) ON CASH HELD IN A FOREIGN CURRENCY</b>	1,130	(2,146)
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS DURING THE YEAR</b>	(15,778)	2,613
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF THE YEAR</b>	42,505	39,892
<b>CASH AND CASH EQUIVALENTS, END OF THE YEAR</b>	26,727	42,505

See accompanying notes to the consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in \$000s except per share and acre amounts)

## 1. DESCRIPTION OF THE BUSINESS

We are a real estate development company with community development, property development, investment property, REIT and recreational property divisions. We develop, manage and own mixed-use residential communities, business and industrial parks, office buildings, retail commercial centres, and golf courses.

Melcor Developments Ltd. ("Melcor" or "we") is incorporated in Canada. The registered office is located at Suite 900, 10310 Jasper Avenue Edmonton, AB T5J 1Y8. We operate in Canada and the United States ("US"). Our shares are traded on the Toronto Stock Exchange under the symbol "MRD". As at December 31, 2018 Melton Holdings Ltd. holds approximately 47.0% of the outstanding shares and pursuant to IAS 24, Related party disclosures, is the ultimate controlling shareholder of Melcor.

As at March 13, 2019, Melcor, through an affiliate, holds an approximate 53.0% effective interest in Melcor REIT ("REIT" or "the REIT") through ownership of all Class B LP Units of the Partnership and is the ultimate controlling party. Melcor continues to manage, administer and operate the REIT and its properties under an asset management agreement and property management agreement. Trust units of the REIT are traded on the Toronto Stock Exchange under the symbol "MR.UN".

## 2. BASIS OF PRESENTATION

We prepare our consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") as set out in Part I of the Chartered Professional Accountants ("CPA") Handbook.

Our consolidated financial statements have been prepared in accordance with IFRS. These consolidated financial statements were authorized for issue by the Board of Directors on March 13, 2019.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in the preparation of these consolidated financial statements are described below.

### A. BASIS OF MEASUREMENT

Our consolidated financial statements have been prepared under the historical cost convention, except for investment properties, derivatives and REIT units which are measured at fair value.

We prepare our financial statements in conformity with IFRS which requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying our accounting policies. Changes in assumptions may have a significant impact on the consolidated financial statements in the period the assumptions change. We believe that the underlying assumptions are appropriate. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in notes 6 and 5, respectively.

### B. BASIS OF CONSOLIDATION

These consolidated financial statements include:

- i. The accounts of Melcor Developments Ltd. and its wholly-owned subsidiaries:
  - Melcor Developments Arizona Inc.
  - Melcor Lakeside Inc.
  - Stanley Investments Inc.
  - Melcor REIT Holdings GP Inc.
  - Melcor REIT Holdings Limited Partnership
  - Melcor Homes Ltd.
- ii. The accounts of Melcor REIT Limited Partnership (the "Partnership") (53.0% owned by Melcor Developments Ltd as at December 31, 2018). The remaining 47.0% publicly held interest in the REIT is presented as a liability in our consolidated financial statements. Refer to notes 7 and 26 for details related to our interest in the REIT.
- iii. Investments in 29 joint arrangements (2017 – 30) with interests ranging from 7% to 60%. These arrangements are undivided interests in the assets, liabilities, revenue and expenses and we record our proportionate share in accordance with the agreements. Refer to note 24 for details on joint arrangements.

All intercompany transactions and balances are eliminated on consolidation.

### C. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are comprised of cash and short-term deposits with maturity dates of less than three months from the date they were acquired.

### D. RESTRICTED CASH

Restricted cash can only be used for specified purposes. As at December 31, 2017 our restricted cash represented amounts held in escrow pending the closing of the Melcor Acquisition (note 26).

### E. LAND INVENTORY

Land inventory is recorded at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less costs to complete the development and selling costs. Cost includes all costs incurred to purchase development land, capitalized carrying costs related to holding the land under development, and development costs to build infrastructure. The estimated unexpended portion of costs to complete building the infrastructure, which are classified as "provision for land development costs" (refer to note 3J), are recorded as a liability upon the approval of the development plan with the municipality.

The cost of land and carrying costs are allocated to each phase of development based on a prorated acreage of the total land parcel at the time a plan is registered with a municipality. The cost of sale of a lot is allocated on the basis of the estimated total cost of the project prorated by the anticipated selling price of the lot over the anticipated selling price of the entire project at the date of plan registration.

Where we acquire land subject to deferred payments greater than one year, it is initially recognized at the fair value of the future estimated contractual obligations.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in \$000s except per share and acre amounts)

### F. INVESTMENT PROPERTIES

Investment properties include commercial, industrial, and residential properties, and a manufactured home community held for the long term to earn rental income or for capital appreciation, or both. It also includes properties under development for future use as investment properties.

Acquired investment properties are measured initially at cost, including related transaction costs associated with the acquisition when the acquisition is accounted for as an asset purchase. Costs capitalized to properties under development include direct development and construction costs, borrowing costs, and property taxes.

After initial recognition, investment properties are recorded at fair value, determined based on the accepted valuation methods of direct income capitalization or discounted future cash flows.

Melcor Developments Ltd. has an internal valuation team consisting of individuals who are knowledgeable and have experience in the fair value techniques applied in valuing investment property. At least once every two years, the valuations are performed by qualified external valuers who hold recognized and relevant professional qualifications and have recent experience in the location and category of the investment property being valued. Changes in fair value are recognized in the consolidated statements of income and comprehensive income in the period in which they arise.

Fair value measurement of an investment property under development is only applied if the fair value is considered to be reliably measurable. In rare circumstances, investment property under development is carried at cost until its fair value becomes reliably measurable. It may sometimes be difficult to determine reliably the fair value of an investment property under development. In order to evaluate whether the fair value of an investment property under development can be determined reliably, management considers the following factors, among others:

- the provisions of the construction contract;
- the stage of completion;
- whether the project or property is standard (typical for the market) or non-standard;
- the level of reliability of cash inflows after completion;
- the development risk specific to the property;
- past experience with similar construction; and
- status of construction permits.

Subsequent expenditures are capitalized to the asset's carrying amount only when it is probable that future economic benefits associated with the expenditure will flow to Melcor and the cost of the item can be measured reliably. All repairs and maintenance costs are expensed when incurred.

Initial direct leasing costs incurred in negotiating and arranging tenant leases are added to the carrying amount of investment properties. All direct leasing costs are external expenditures and no amounts for internal allocations are capitalized with respect to the negotiation or arranging of tenant leases.

### G. PROPERTY AND EQUIPMENT

Property and equipment is initially measured at cost, which includes expenditures that are directly attributable to the acquisition of the asset. Subsequent to its initial recognition, property and equipment is carried at cost less accumulated depreciation and any accumulated impairment losses.

The major categories of property and equipment are depreciated using the declining balance method of depreciation as follows:

Buildings	4%
Golf course greens and tees	6%
Golf course equipment	20-30%
Corporate assets	20-50%

Property and equipment is tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash inflows. The recoverable amount is the higher of an asset's fair value less costs to sell and the discounted expected future cash flows of the relevant asset or group of assets calculated on a value-in-use basis. An impairment loss is recognized for the amount by which the asset or group of assets' carrying amount exceeds its recoverable amount.

We evaluate impairment losses for potential reversals when events or circumstances warrant such consideration.

### H. OTHER ASSETS

Other assets include prepaid expenses, inventory, deposits, straight-line rent adjustments and tenant incentives incurred in respect of new or renewed leases. Tenant incentives are amortized on a straight-line basis over the lease term and are recorded as a reduction of revenue.

### I. BORROWING COSTS

General and specific borrowing costs attributable to the acquisition, construction or production of qualifying assets are added to the cost of those assets. Borrowing costs are capitalized while acquisition or construction is actively underway and ceases once the asset is substantially complete, or suspended if the development of the asset is suspended. The amount of borrowing cost capitalized is determined by applying a weighted average cost of borrowings to qualifying assets. Qualifying assets include our land under development and investment properties under development assets. All other borrowing costs are recognized as finance costs in the consolidated statement of income in the period in which they are incurred.

### J. PROVISION FOR LAND DEVELOPMENT COSTS

We recognize a provision for land development related to the construction, installation and servicing of municipal improvements related to subdivisions under development once we have an approved development agreement with the municipality, as this is the point in time when an obligation arises. The provision is recognized as a liability with an equal amount capitalized to land inventory. Provisions for land development are measured at management's best estimate of the expenditure required to complete the approved development plan at the end of the reporting period. Adjustments are made to the liability with a corresponding adjustment to cost of sales as actual costs are incurred. Provisions are discounted, where material, by discounting the expected future cash flows at a rate that reflects risk specific to the provision and the time value of money.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in \$000s except per share and acre amounts)

### K. PROVISION FOR DECOMMISSIONING OBLIGATIONS

Decommissioning obligations are measured at the present value of the expected cost to settle the obligation. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows as well as any changes in the discount rate. Increases or decreases in the provision are recognized as an expense or income. Actual costs incurred upon settlement of the decommissioning obligation are recorded against the provision.

### L. RECOGNITION OF REVENUE

Revenue is generated from contracts with customers and other revenues. Contracts with customers include the sale of developed land, golf course operations and service revenue from investment properties. Other revenues include rental revenue from investment property leases and management fees from joint venture operations.

Revenue from contracts related to the sale of developed land is recognized at a point in time, which is when a minimum of 15% of the sale price has been received, the sale is unconditional and possession has been granted. All contracts related to the sale of developed land have one performance obligation, the delivery of a fully developed lot to the customer. Common areas within a development community that are subsequently transferred to municipal or government organizations or home-owner associations are not considered an extension of a customer and therefore; this does not represent a separate performance obligation.

Revenue from golf course operations (green fees, food and beverage) is recognized at a point in time and the performance obligation is satisfied in the accounting period in which the services are provided. Membership revenue from golf courses is recognized over time on a monthly basis in the period in which the performance obligations are completed.

Service revenues are amounts outlined separately in the lease agreement for distinct services provided including utilities, maintenance and security recoveries from tenants which are recognized on a monthly basis in the period in which the corresponding costs are incurred and performance obligations are completed.

Rental revenues include both lease and service revenue components. Lease revenues from investment properties include base rents, recoveries of operating expenses including property taxes, parking revenue, incidental income and sign and storage lease revenue. Revenue recognition under a lease commences when the tenant has a right to use the leased asset. The total amount of contractual rent to be received from the operating leases is recognized on a straight line basis over the term of the lease; a straight line rent receivable which is included in other assets, is recorded for the difference between the rental revenue recognized and the contractual amount received. When incentives are provided to our tenants, the cost of these incentives is recognized over the lease term, on a straight line basis as a reduction to rental revenue.

Investment property leases are accounted for as operating leases given that we have retained substantially all of the risks and benefits of the ownership of our investment properties.

Management fee revenue is comprised of fees paid by our joint arrangement partners based on development and/or sales activities, which fluctuates period to period depending on the stage of various projects.

### M. INCOME TAXES

Current income tax is the expected amount of tax payable to the taxation authorities, using tax rates enacted, or substantively enacted, at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized using the liability method based on the temporary differences between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax assets are the result of recognizing the benefit associated with deductible temporary differences, unused tax credits, and tax loss carryforwards. The carrying amount of the deferred tax liabilities and assets is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the reporting period date and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered.

We presume that investment property measured at fair value will be recovered entirely through sale. Measurement of the related deferred taxes reflects the tax consequences of recovering the carrying amount through sale.

The REIT qualifies as a mutual fund trust within the meaning of the Income Tax Act (Canada) ("Tax Act") and as a real estate investment trust eligible for the 'REIT Exception', as defined in the rules applicable to Specified Investment Flow-Through ("SIFT") trusts and partnerships in the Tax Act. We expect to allocate all of the REIT's taxable income and to continue to qualify for the REIT Exception. As the REIT is a flow-through entity, we record current and deferred taxes on our 53.0% interest in the REIT.

### N. STOCK BASED COMPENSATION

We use the Black-Scholes option pricing model to fair value options granted to our employees, and the intrinsic method to fair value restricted share units ("RSUs"). The estimated fair value of awards on the date of grant is recognized as compensation expense on a graded vesting basis over the period in which the employee services are rendered. We estimate the number of expected forfeitures at the grant date and make adjustments for actual forfeitures as they occur. Stock based awards that give the holder the right to purchase shares are accounted for as equity-settled plans.

### O. EARNINGS PER SHARE

Basic earnings per share ("EPS") is calculated by dividing our net income for the period by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, warrants, and similar instruments is computed using the treasury stock method. Our potentially dilutive common shares comprise stock options and RSUs granted to employees.

### P. FOREIGN CURRENCY

The consolidated financial statements are presented in Canadian dollars, which is the functional currency for our Canadian operations and our presentation currency.

Assets and liabilities of our US operations, for which the functional currency is the US dollar, are translated into our presentation currency at the exchange rates in effect at the reporting period end.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in \$000s except per share and acre amounts)

date and revenues and expenses are translated at average exchange rates for the period. Gains or losses on translation of foreign operations are recognized as other comprehensive income or loss.

Gains or losses on the settlement of debt or on foreign exchange cash balances are recognized in income in the period realized.

### Q. FINANCIAL INSTRUMENTS

At initial recognition, we classify our financial instruments in the following categories depending on the purpose for which the instruments were acquired:

#### FINANCIAL ASSETS

Finance assets that are held for collection of contractual cash flows represent solely payments of principle and interest are measured at amortized cost. This includes cash and cash equivalents, restricted cash, accounts receivable and agreements receivable. Financial assets are initially recognized at fair value plus transaction costs, adjusted for an expected credit loss. Subsequently, receivables are measured at amortized cost using the effective interest rate method adjusted for expected credit losses.

For financial assets, Melcor applies the simplified expected credit loss approach, which requires expected lifetime losses to be recognized from initial recognition of the accounts receivables and agreements receivables.

#### FINANCIAL LIABILITIES

Other liabilities are initially recognized at fair value, net of any transaction costs incurred. Other liabilities include accounts payable and accrued liabilities, and general debt. REIT Units are classified as fair value through profit or loss ("FVTPL") and are designated as FVTPL to offset the accounting mismatch of REIT investment properties carried at fair value.

We record our financial liabilities at fair value on initial recognition. Subsequently, financial liabilities are measured at amortized cost using the effective interest rate method and financial liabilities designated as FVTPL are remeasured at fair value with changes in their fair value recorded through income.

Modifications of financial liabilities carried at amortized cost that do not result in derecognition give rise to a modification gain or loss equal to the change in discounted contractual cash flows using the original effective interest rate. This modification gain or loss is recognized in the consolidated statements of net income and comprehensive income.

#### FINANCIAL GUARANTEE CONTRACTS

Financial guarantee contracts are recognized as a financial liability at the time the guarantee is issued. The liability is initially measured at fair value and subsequently at the higher of:

- i. the amount determined in accordance with the expected credit loss model under IFRS 9, Financial Instruments, and
- ii. the amount initially recognized less, when appropriate, the cumulative amount of income recognized in accordance with the principles of IFRS 15, Revenue from Contracts with Customers.

The fair value of financial guarantees is determined based on the present value of the difference in cash flows between the contractual payments required under the debt instrument and the payments that would be required without the guarantee, of the estimated amount that would be payable to a third party for assuming the obligations.

Where guarantees in relation to loans or other payables of associates are provided for no compensation, the fair values are accounted as contributions and recognized as part of the cost of the investment.

### R. NON-CONTROLLING INTEREST IN MELCOR REIT

We hold an effective 53.0% interest in the REIT through ownership of all Class B LP Units. A non-controlling interest, REIT units, has been recognized on the statement of financial position to reflect the 47.0% interest held by the public through ownership of all trust units. The trust units are redeemable at the option of the holder and, therefore, are considered a puttable instrument in accordance with International Accounting Standard ("IAS") 32, Financial Instruments – Presentation ("IAS 32"). Certain conditions under IAS 32 allow the REIT to present the trust units as equity; however, on consolidation we do not meet these conditions and therefore must present the non-controlling interest as a financial liability.

As a financial liability designated as fair value through profit or loss ("FVTPL") we recorded the REIT units at fair value on initial recognition. Subsequent to initial recognition we remeasure the liability each period at fair value based upon the trust unit's closing trading price. Fair value gains and losses are recorded through income in the period they are incurred.

Distributions on trust units are recognized in the period in which they are approved and are recorded as an expense in income. For presentation purposes we aggregate the distribution expense with the fair value adjustment on the trust units under the caption 'adjustments related to REIT units'.

### S. FINANCIAL DERIVATIVES

Our financial derivatives include interest rate swaps and the conversion feature on the REIT convertible debenture. Derivatives are initially recognized at fair value on the date a derivative contract is entered into and subsequently remeasured at their fair value. The host instrument financial liability is recognized initially at the fair value of a similar liability that does not have conversion feature. The conversion feature is separated from the host instrument and recognized at fair value. The fair value of the host instrument is recorded net of any related transaction costs. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged.

Derivative instruments are recorded in the consolidated statement of financial position at their fair value. Changes in fair value of derivative instruments that are not designated as hedges for accounting purposes are recognized in the income statement.

Melcor has not designated any derivatives as hedges for accounting purposes.

### T. OPERATING SEGMENTS

Our operating segments are strategic business units that offer different products and services, and are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in \$000s except per share and acre amounts)

### U. STATEMENT OF CASH FLOWS

Development activities is defined as the net change of land inventory and the provision for land development costs and excludes the purchase of raw land. Purchase of raw land is the cost of land net of vendor financing received (see note 10 – land inventory).

Operating assets and liabilities is defined as the net change of accounts receivable, deposits, prepaids and inventory, income taxes payable, accounts payable and accrued liabilities and deferred finance costs capitalized during the year. Excluded from operating assets and liabilities are investment property additions that are unpaid and included in accounts payable and accrued liabilities at year end.

## 4. ACCOUNTING STANDARD CHANGES

### A. NEW AND AMENDED STANDARDS ADOPTED

We have adopted the following new standard interpretation effective January 1, 2018.

- i. **IFRS 15 Revenue from Contracts with Customers** supersedes IAS 18, 'Revenue', IAS 11, 'Construction Contracts' and other interpretive guidance associated with revenue recognition. IFRS 15 is to be applied to each prior reporting period presented retrospectively or through the recognition of the cumulative effect to opening retained earnings.

#### *Impact of adoption*

The adoption of IFRS 15 was done through the modified retrospective approach and did not result in any adjustments upon transition, change in recognition or timing of recognition of revenue from contracts in Melcor. Adoption does require additional detail included within our recognition of revenue policy (note 3L), and disclosures to the year end financial statements to distinguish between revenue related to lease contracts, joint ventures and revenues earned from contracts with customers, as well as the timing of revenue recognition for revenues earned from contracts with customers (note 22).

Lease revenues will continue to be accounted for under IAS 17, Leases, with the exception of any service component revenue earned on a lease contract which will now be accounted for under IFRS 15. Management fee revenue earned on Melcor's joint arrangements will continue to be accounted for under IFRS 11 and revenues from land sales and golf courses will be accounted for under IFRS 15.

- ii. **IFRS 9, Financial Instruments** replaces IAS 39 and introduces a new classification and measurement model with three classification categories, 'amortized cost', 'fair value' and 'fair value through other comprehensive income', for financial assets, as well as an expected loss impairment model that requires more timely recognition of expected credit losses and a new hedge accounting model.

#### *Impact of adoption*

The adoption of IFRS 9 did not result in any adjustments upon transition. Financial assets which include cash and cash equivalents, restricted cash, accounts receivable and agreements receivables were previously classified as Loans and Receivable are now classified as amortized cost. This change in classification did not result in any changes in measurement of financial assets in Melcor, but did require a change to the our Financial Instruments policy (note 3Q).

Melcor was required to revise its impairment methodology under IFRS 9 for its financial assets, to account for expected credit losses. To measure the expected credit loss, financial assets have been grouped based on shared credit risk characteristics, days past due or past due. While our financial assets are subject to the expected credit loss requirements, the identified loss was immaterial.

There was no impact to the measurement, recognition or disclosures of financial liabilities, and Melcor does not apply hedge accounting.

- iii. **IAS 40, Investment Properties** clarifies the principles for transfer into, or out of, investment property when there has been a change in use. We have applied the amendments prospectively in accordance with the transitional provisions.

#### *Impact of adoption*

The adoption of IAS 40 did not result in any impact on the classification of existing property at January 1, 2018, no reclassifications and no change to the timing of transfers subsequent to January 1, 2018.

Other standards, amendments and interpretations that were effective for the year beginning January 1, 2018 are not material to Melcor.

### B. NEW STANDARDS NOT YET ADOPTED

- i. **IFRS 16, Leases** was issued in January 2016 by the IASB to replace IAS 17. IFRS 16 includes several changes in the method of accounting for operating leases, including:
    - (i) All leases will be on the balance sheet of lessees, except those that meet the limited exception criteria;
    - (ii) Rent expense for leases on the balance sheet will be recorded as depreciation and finance expenses;
    - (iii) Timing of expenses will change as the finance lease model results in an accelerated recognition of expenses compared to a straight-line operating lease model.
- IFRS 16 is required to be applied for annual periods beginning on or after January 1, 2019. We have completed our evaluation of the impact of this standard on our financial statements and concluded that there is no material impact.
- ii. **IFRIC 23, Uncertainty over income tax treatments** clarifies the application of the recognition and measurement requirements in AIS12, "Income Taxes" ("IAS 12"), for situations where there is uncertainty over income tax treatments, IFRIC 23 specifically addresses whether;
    - (i) an entity considers income tax treatments separately;
    - (ii) assumptions that an entity makes regarding the examination of tax treatments by taxation authorities;
    - (iii) how an entity determines taxable income or loss, tax basis, unused tax losses or credits, and tax rates;
    - (iiii) how an entity considers changes in facts and circumstances.

IFRIC 23 does not apply to taxes or levies outside the scope of IAS 12. IFRIC 23 is effective for annual periods beginning on or after January 1, 2019. We are currently evaluating the impact of adopting this interpretation to the consolidated financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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- iii. **IFRS 3, Business combinations** amendments were made to IFRS 3, Business combinations in order to clarify that obtaining control of a business that is a joint operation is a business combination achieved in stages. Amendments to IFRS 3 are effective for annual periods beginning on or after January 1, 2020. We are currently evaluating the impact of adopting the amendments to this standard to the consolidated financial statements.

### 5. CRITICAL ACCOUNTING ESTIMATES

We make estimates and assumptions that affect the carrying amounts of assets and liabilities, disclosure of contingent liabilities and the reported amount of income for the period. Actual results could differ from estimates previously reported. The estimates and assumptions that are critical to the determination of the amounts reported in the financial statements relate to the following:

#### A. VALUATION OF AGREEMENTS RECEIVABLE

We review our agreements receivable on a regular basis to estimate the risk of default on outstanding balances. Factors such as the related builder's reputation and financial status, the geographic location of the lot, and length of time the agreement receivable has been outstanding are all considered when estimating any impairment on agreements receivable. Refer to note 28A for further information related to credit risk associated with agreements receivable.

#### B. VALUATION OF INVESTMENT PROPERTIES

The fair value of investment property is dependent on stabilized net operating income or forecasted future cash flows and property specific capitalization or discount rates. The stabilized net operating income or forecasted future cash flows involve assumptions of future rental income, including estimated market rental rates and vacancy rates, estimated direct operating costs and estimated capital expenditures. Capitalization and discount rates take into account the location, size and quality of the property, as well as market data at the valuation date.

Refer to note 29 for further information about methods and assumptions used in determining fair value of investment properties.

#### C. DETERMINATION OF THE PROVISION FOR LAND DEVELOPMENT COSTS

We estimate the future costs of completing the development of land by preparing internal budgets of costs and reviewing these estimates regularly to determine if adjustments to increase or decrease the provision for land development costs are required. This estimate impacts the measurement of cost of sales reported given that land inventory is sold prior to all costs being committed or known as the nature of land development considers a long-term time frame to complete all municipal requirements.

#### D. INCOME TAXES

Significant estimates are required in determining our provision for income taxes. We recognize liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current tax and deferred tax provision.

The deferred tax assets recognized at December 31, 2018 are supported by future profitability assumptions over a five-year horizon. In the event of changes in these profitability assumptions the tax assets recognized may be adjusted.

### 6. SIGNIFICANT JUDGMENTS

In the process of applying our accounting policies, we make various judgments, apart from those involving estimations, that can significantly impact the amounts recognized in the financial statements. These include:

#### A. CAPITALIZATION OF BORROWING COSTS

IAS 23, Borrowing Costs, requires the capitalization of borrowing costs to qualifying assets. IAS 23 also requires the determination of whether the borrowings are specific to a project or general in calculating the capitalized borrowing costs. Judgment is involved in identifying directly attributable borrowing costs to be included in the carrying value of qualifying assets and in determining if funds borrowed are for general purposes or specifically for the construction of qualifying assets. We consider our centrally managed treasury function with assessment of the circumstances surrounding individual borrowings in making this judgment. Capitalization to land inventory occurs when the land is classified to land under development and ceases when the land is considered developed and ready for sale. Borrowing costs are capitalized to investment properties when under active development. We have determined that all of our borrowings are general, except project specific financing (note 16C), as the decision on how to deploy operating and acquisition funds is a centrally managed corporate decision.

#### B. TRANSFER OF LAND TO INVESTMENT PROPERTY

We typically acquire raw land with the intent of developing it in our Community Development division. When development plans are formulated, we may decide that specific land holdings will be developed into investment properties. Once appropriate evidence of a change in use is established, typically on inception of an operating lease for the investment property, the land is transferred to investment properties. At that time, the land is recognized at fair value in accordance with our accounting policy for investment properties, and any gain or loss is reflected in earnings in the period the transfer occurs.

#### C. CLASSIFICATION OF TENANT INCENTIVES

Payments are often made to tenants of our commercial properties when new leases are signed. When the payments add future value to the space independent of the lease in place, such costs are capitalized to the investment property. If the costs incurred are specific to the lessee, and do not have stand-alone value, these costs are treated as tenant incentives and amortized on a straight-line basis to revenue over the lease term in accordance with SIC 15, Operating leases – incentives.

#### D. INVESTMENT PROPERTIES

Our accounting policies related to investment properties are described in note 3F. In applying this policy, judgment is required in determining whether certain costs are additions to the carrying amount of an investment property and, for properties under development, identifying the point at which substantial completion of the property occurs.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in \$000s except per share and acre amounts)

In determining the fair value of our investment property, judgment is required in assessing the 'highest and best use' as required under IFRS 13, Fair value measurement. We have determined that the current use of our investment properties is its 'highest and best use'.

### E. COMPLIANCE WITH REIT EXEMPTION UNDER ITA

Under current tax legislation, a real estate investment trust is not liable for Canadian income taxes provided that its taxable income is fully allocated to unitholders during the year. In order for the Trust to continue to be taxed as a mutual fund trust, we need to maintain its REIT status. At inception, the Trust qualifies as a REIT under the specified investment flow-through ("SIFT") rules in the Canadian Income Tax Act. The Trust's current and continuing qualification as a REIT depends on the Trust's ability to meet the various requirements imposed under the SIFT rules, which relate to matters such as its organizational structure and the nature of its assets and revenues. We apply judgment in determining whether it continues to qualify as a REIT under the SIFT rules. Should the Trust cease to qualify, it would be subject to income tax on its earnings.

### 7. INTEREST IN MELCOR REIT

As at December 31, 2018 we hold a 53.0% (2017 - 56.7%) ownership interest in the REIT through ownership of all 14,899,325 Class B LP Units of the Partnership.

The publicly held interest in the REIT is presented as a liability in our consolidated financial statements. Refer to note 26 for summary financial information of the REIT at December 31, 2018. As of March 13, 2019 we hold a 53.0% ownership interest in the REIT.

### 8. ASSET HELD FOR SALE

On January 31, 2018, we disposed of an industrial property previously held for sale for proceeds of \$6,732 (net of transaction costs and including tenant incentives of \$66 and straight line rent of \$24). The sale price was settled through mortgage assumption of \$3,662 and cash of \$3,070 (note 11).

### 9. AGREEMENTS RECEIVABLE

Agreements receivable are due in 2019, except for \$28,291 due in 2020 (2017 - balance due 2018, except \$46,929 due in 2019 and \$1,449 due in 2020). Subsequent to the interest adjustment date, which provides an interest relief period to qualifying registered builders, these receivables earn interest at prime plus two percent (5.95% at December 31, 2018) and are collateralized by the specific real estate sold.

Management monitors agreements receivables for indications of impairment on an ongoing basis. Balances are reduced to their estimated net realizable values when there is doubt regarding collection of the full amount of principal and interest in accordance with the expected credit loss model.

At December 31, 2018, promotional programs of \$1,388 (2017 - \$nil) were offered to promote sales activities and encourage agreements receivable collections. This amount was determined based on management's best estimate and is subject to measurement uncertainty introduced by the impact of the uncertain economic environment. As a result, revisions to this estimate may be required in future periods. Refer to note 28A for further discussion surrounding credit risk.

As at the prior year end, and during the 2018 fiscal year, we had an agreements receivable balance due from one of our registered builders that is currently in receivership. Melcor held title to the lots sold to this builder as specific security against this balance and performed assessments of the collectibility of the underlying security for these agreements, resulting in no impairment. As of December 31, 2018 we no longer have any outstanding balances with this builder, as all lots previously held by this builder have been subsequently sold to separate home builders or collected on.

## 10. LAND INVENTORY

<i>As at December 31</i>	2018	2017
Raw land held	387,356	383,843
Land under development	136,534	137,872
Developed land	235,050	207,585
	<b>758,940</b>	<b>729,300</b>

A breakdown of our land purchases are as follows:

	2018	2017
Land purchases - acres	200 acres	771 acres
Land purchases - lot/inventory	—	294 lots
Land cost	10,446	59,775
Vendor financing	2,625	17,196
Net cash to close	7,821	42,579

During the year, certain land inventories were reclassified to investment properties, and fair value gains of \$1,015 (2017 - \$342) were recognized in the consolidated financial statements. For the purposes of segment reporting, this is disclosed as revenue of \$3,085 (2017 - \$1,868) and cost of sales of \$2,070 (2017 - \$1,526) for the Community Development division.

The weighted average interest rate used for capitalization of borrowing costs to land under development is 4.34% for the year ended December 31, 2018 (2017 - 3.97%). Borrowing costs capitalized to land inventory during the year were \$4,189 (2017 - \$3,603).

Land inventory expensed to cost of sales during the year was \$97,695 (2017 - \$97,588).

The net realizable value exceeds the carrying cost of all land inventories at December 31, 2018 and 2017, such that no provision for impairment is required.

## 11. INVESTMENT PROPERTIES

Investment properties consists of the following:

<i>As at December 31</i>	2018	2017
Investment properties	965,339	907,310
Properties under development	67,348	68,546
Total	<b>1,032,687</b>	<b>975,856</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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The following table summarizes the change in investment properties during the year:

2018			
As at December 31	Investment properties	Properties under development	Total
Balance - beginning of year	907,310	68,546	975,856
<b>Additions</b>			
Direct acquisition	33,541	—	33,541
Transfer from land inventory	—	2,070	2,070
Direct leasing costs	1,054	803	1,857
Property improvements	3,897	—	3,897
Property development	3	16,574	16,577
Capitalized borrowing costs	—	943	943
Disposals	(13,321)	—	(13,321)
Transfers	29,959	(29,959)	—
Fair value adjustment on investment properties	(7,508)	8,371	863
Foreign currency translation (included in OCI)	10,404	—	10,404
Balance - end of year	965,339	67,348	1,032,687

2017			
As at December 31	Investment properties	Properties under development	Total
Balance - beginning of year	929,299	41,394	970,693
<b>Additions</b>			
Direct acquisition	—	1,526	1,526
Transfer from land inventory	1,117	287	1,404
Direct leasing costs	4,088	—	4,088
Property improvements	73	31,781	31,854
Property development	—	208	208
Capitalized borrowing costs	(10,919)	—	(10,919)
Disposals	10,302	(10,302)	—
Transfers	(12,480)	3,652	(8,828)
Fair value adjustment on investment properties	(6,642)	—	(6,642)
Foreign currency translation (included in OCI)	(7,528)	—	(7,528)
Balance - end of year	907,310	68,546	975,856

### ACQUISITIONS:

On September 26, 2018 we purchased an office property in Glendale, AZ consisting of two buildings for \$24,532 (US\$18,907) (including transaction costs). The acquisition was accounted for as an asset purchase in accordance with our policy.

On December 3, 2018 we purchased two investment properties in Lethbridge, AB. An office building at a purchase price of \$6,322 (including transaction costs) and a commercial building at a purchase price of \$2,687 (including transaction costs). These acquisitions were accounted for as asset purchases in accordance with our policy.

### DISPOSALS:

On April 16, 2018 we sold an investment property for \$13,319 (net of transaction costs and including tenant incentives of \$434 and straight line rent of \$80). Concurrent with the sale we paid off the associated mortgage liability which had a balance of \$6,947.

Also during the year, we disposed of two residential units in Arizona for a sales price of \$261 and \$255 (US\$212 and US \$199) (net of transaction costs). The sale price was settled through cash.

### ACQUISITIONS AND DISPOSALS IN THE COMPARATIVE YEAR:

During 2017 there were no direct acquisitions made. The following dispositions were made from our portfolio:

- On April 27, 2017, we disposed of an industrial property in Lethbridge, Alberta for a sale price of \$7,760 (net of transaction costs). The sale price was settled through mortgage assumption of \$2,640, issuance of vendor-take-back mortgage of \$900, and cash of \$4,220. The vendor-take-back (VTB) mortgage bears interest at an annual rate of 6.00%, with interest only payments payable monthly over a 36 month term. The VTB can be prepaid in whole or in part without penalty, as of December 31, 2018 the balance of this VTB is \$900.
- On July 11, 2017, we disposed of a parking lot in Edmonton, Alberta for cash consideration of \$2,986 (net of transaction costs).
- On November 15, 2017 we disposed of a residential unit in the US for \$173 (US\$133) cash consideration (net of transaction costs)

In accordance with our policy, as detailed in note 3F, we record our investment properties at fair value. Fair value adjustments on investment properties are primarily driven by changes in capitalization rates and stabilized NOI, while development activity on properties under development and leasing activity drive fair value adjustments on properties under development. Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 29.

Properties transferred from property under development to commercial properties during the year totaled \$29,959 (2017 - \$10,302). Properties transferred is net of tenant incentives of \$391 (2017 - \$398).

Presented separately from investment properties is \$34,243 (2017 - \$34,716) in tenant incentives and \$11,702 (2017 - \$9,648) in straight-line rent adjustments (included in note 13). The fair value of investment properties has been reduced by these amounts.

The weighted average interest rate used for capitalization of borrowing costs to investment properties under development is 4.37% for the year ended December 31, 2018 (2017 - 3.77%).

Our investment properties are leased to tenants primarily under long term operating leases. Rentals are receivable from tenants monthly. Minimum lease payments under non-cancellable operating leases of investment properties are receivable as follows:

	2018	2017
Within one year	63,571	55,788
Later than one year but not later than 5 years	191,847	172,736
Later than 5 years	129,321	109,200
Total	384,739	337,724

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### 12. PROPERTY AND EQUIPMENT

	Golf Course Assets				Corporate	Total
	Land	Buildings	Equipment	Greens and tees		
January 1, 2018						
Cost	1,293	8,116	8,446	6,517	6,358	30,730
Accumulated depreciation	—	(2,850)	(6,171)	(3,167)	(3,884)	(16,072)
Opening net book value	1,293	5,266	2,275	3,350	2,474	14,658
Additions	—	31	497	84	186	798
Disposals	—	—	(5)	—	(14)	(19)
Depreciation	—	(208)	(550)	(206)	(453)	(1,417)
Net Book Value - December 31, 2018	1,293	5,089	2,217	3,228	2,193	14,020

	Golf Course Assets				Corporate	Total
	Land	Buildings	Equipment	Greens and tees		
January 1, 2017						
Cost	1,293	8,053	8,350	6,498	6,675	30,869
Accumulated depreciation	—	(2,636)	(5,939)	(2,948)	(3,839)	(15,362)
Opening net book value	1,293	5,417	2,411	3,550	2,836	15,507
Additions	—	63	448	19	96	626
Disposals	—	—	(20)	—	(18)	(38)
Depreciation	—	(214)	(564)	(219)	(440)	(1,437)
Net Book Value - December 31, 2017	1,293	5,266	2,275	3,350	2,474	14,658

### 13. OTHER ASSETS

	2018	2017
Tenant incentives	34,243	34,716
Deposits and prepaids	6,930	3,837
Straight-line rent adjustments	11,702	9,648
Inventory	488	509
	53,363	48,710

During the year we provided tenant incentives of \$6,671 (2017 - \$4,540) and recorded \$6,710 (2017 - \$6,304) of amortization expense. In accordance with SIC 15, Operating leases - incentives, amortization of tenant incentives are recorded on a straight-line basis over the term of the lease against rental revenue. We also disposed of a property which included \$434 in tenant incentives and \$80 in straight-line rent adjustments (note 11).

### 14. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2018	2017
Trade accounts payable	14,389	21,674
Distribution payable	743	630
Other payables	28,114	28,151
Provision for decommissioning obligation	1,579	1,524
	44,825	51,979

As described in note 3R distributions on trust units are recognized in the period in which they are approved and are recorded as an expense. As at December 31, 2018, distribution payable pertains to the December 2018 monthly distribution which was subsequently paid on January 15, 2019 (2017 - December 2017 monthly distribution paid on January 15, 2018).

Decommissioning obligation relates to one of our commercial properties held by the REIT. The total decommissioning obligation is estimated based on the future obligation and timing of these expenditures to be incurred. We estimate the net present value of the obligation based on an undiscounted total future provision of \$2,014 (December 31, 2017 - \$2,014). At December 31, 2018, a discount rate of 4.00% (December 31, 2017 - 4.00%) and an inflation rate of 2.00% (December 31, 2017 - 2.00%) were used to calculate the net present value of the obligation. Due to uncertainty surrounding the nature and timing of this obligation, amounts are subject to change.

### 15. PROVISION FOR LAND DEVELOPMENT

	2018	2017
Balance - beginning of year	87,139	91,584
New development projects	114,482	86,160
Changes to estimates	(5,371)	(4,037)
Costs incurred	(118,592)	(86,568)
Balance - end of year	77,658	87,139

### 16. GENERAL DEBT

As at (\$000s)	2018	2017	
Melcor - revolving credit facilities	a	46,529	76,529
REIT - revolving credit facility	b	—	—
Project specific financing	c	62,639	20,926
Secured vendor take back debt on land inventory	d	40,842	64,891
Debt on investment properties and golf course assets	e	454,342	444,807
REIT - convertible debentures	f	55,204	54,775
Total general debt		659,556	661,928
Less: Liabilities held for sale (note 8)		—	(3,670)
General debt		659,556	658,258

#### A. MELCOR - REVOLVING CREDIT FACILITIES

We have available credit facilities with approved loan limits of \$200,103 (2017 - \$205,603) with a syndicate of major chartered banks. The portion of these loan limits that pertain solely to Melcor is \$120,000 (2017 - \$120,000) with the remaining balance pertaining to specific joint arrangements.

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The amount of the total credit facilities currently used is \$46,529 (2017 - \$76,529). We have pledged agreements receivable, specific lot inventory, undeveloped land inventory and a general security agreement as collateral for our credit facilities. The carrying value of assets pledged as collateral is \$288,745 (2017 - \$364,181).

The facilities mature on July 31, 2020, renewable one year in advance of expiry.

Depending on the form under which the credit facilities are accessed, rates of interest will vary between prime plus 0.75% to prime plus 2.25% or banker's acceptance rate plus a 3.00% stamping fee resulting in interest rates ranging from 4.70% to 6.20% at December 31, 2018 (2017 - 3.95% to 5.45%). The agreements also bear a standby fee of 0.50% for the unused portions of the facilities. The weighted average effective interest rate on borrowings, based on year end balances, is 5.16% (December 31, 2017 - 4.52%).

### B. REIT – REVOLVING CREDIT FACILITY

On June 1, 2018 we entered into the first amendment on the REIT revolving credit facility agreement with our existing lenders. Under the terms of the amending agreement the REIT maintains an available credit limit based upon the carrying value of specific investment properties to a maximum of \$35,000 for general corporate purposes and acquisitions, including a \$5,000 swingline sub-facility. An additional \$10,000 is available by way of an accordion feature, subject to lender approval. Depending on the form under which the new facility is accessed, rates of interest will vary between prime plus 1.25% or bankers' acceptance plus 2.25% stamping fee. The agreement also provides the REIT with \$5,000 in available letters of credit which bear interest at 2.25%. Interest payments are due and payable based upon the form of the facility drawn upon, and principal is due and payable upon maturity. The agreement also bears a standby fee of 0.45% for the unused portion of the new facility. The lenders hold demand debentures, a first priority general security and a general assignment of leases and rents over specific investment properties as security for the new facility. The facility matures June 1, 2021.

As at December 31, 2018, the carrying value of pledged properties was \$54,547 (December 31, 2017 - \$56,258).

As at December 31, 2018 we had \$nil (December 31, 2017 - \$nil) drawn from the facility; and posted letters of credit of \$150 (December 31, 2017 - \$nil). The weighted average effective interest rate on borrowings as at December 31, 2018 was 3.95% (2017 - 3.48%).

### C. PROJECT SPECIFIC FINANCING

	2018	2017
Project specific debt on land, with interest rates between 4.95% and 9.48% (2017 - 4.58% to 5.70%)	31,828	8,709
Project specific debt on investment properties under development, with interest rates between 4.25% and 4.45% (2017 - 3.50% to 3.70%)	30,811	12,217
	<b>62,639</b>	20,926

As at December 31, 2018 \$19,791 (2017 - \$nil) of debt was payable in US dollars (2018 - US \$14,507 and 2017 - US \$nil). The debts mature from 2019 to 2029.

Land inventory and agreements receivable with a December 31, 2018 carrying value of \$80,241 (2017 - \$22,173) have been pledged as collateral on project specific debt on land. The debts

are due on demand by the lenders. The weighted average interest rate on the above debts, based on year end balances, is 6.67% (2017 - 4.94%). Specific investment properties under development with a December 31, 2018 carrying value of \$54,375 (2017 - \$40,715), have been pledged as collateral on project specific debt on investment properties under development.

The change in project specific financing during the year is summarized as follows:

	2018	2017
Balance - beginning of year	20,926	5,213
<b>Cash movements</b>		
Loan repayments	(11,629)	(3,554)
New project financing	52,319	19,267
<b>Non-cash movements</b>		
Foreign currency translation included in OCI	1,023	—
Balance - end of year	<b>62,639</b>	20,926

### D. SECURED VENDOR TAKE BACK DEBT ON LAND INVENTORY

	2018	2017
Agreements payable with interest at the following contractual rates:		
Fixed rates of 3.00% - 5.95% (2017 - 3.00% to 6.00%)	36,460	58,318
Variable rate of 5.95% (2017 - 5.20%)	4,382	6,573
	<b>40,842</b>	64,891

As at December 31, 2018 there was no debt payable in US dollars (2017 - \$10,622 and US\$8,467).

Land inventory with a December 31, 2018 carrying value of \$84,757 (2017 - \$131,440), has been pledged as collateral for the above debt. The weighted average effective interest rate for the above debts, based on year end balances, is 4.69% (2017 - 5.04%).

The minimum contractual principal payments due within each of the next five years are as follows:

	2018	2017
2019		20,377
2020		18,671
2021		1,434
2022		360
Thereafter		—
		<b>40,842</b>

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The change in secured vendor take back debt on land inventory during the year is as follows:

	2018	2017
Balance - beginning of year	64,891	65,408
<b>Cash movements</b>		
Principal repayments		
Scheduled amortization on debt	(26,742)	(16,407)
<b>Non-cash movements</b>		
New secured vendor take back debt	2,625	17,195
Amortization of non-cash interest	(280)	(402)
Foreign currency translation included in OCI	348	(903)
Balance - end of year	40,842	64,891

### E. DEBT ON INVESTMENT PROPERTIES AND GOLF COURSE ASSETS

	2018	2017
Variable rate mortgages amortized over 10 to 30 years at variable interest rates of 2.85% - 5.57% (2017 - 2.85% to 4.70%)	55,589	57,602
Mortgages amortized over 15 to 25 years at fixed interest rates of 2.54% - 5.35% (2017 - 2.54% to 6.16%)	401,865	390,285
	457,454	447,887
Fair value adjustment for interest rate swaps	(803)	(1,057)
Unamortized deferred financing fees	(2,309)	(2,023)
	454,342	444,807
Interest rate ranges	(2.54% -5.57%)	(2.48% -6.16%)

As at December 31, 2018 \$71,247 (2017 - \$52,362) of debt was payable in US dollars (2018 - US \$52,226 and 2017 - US \$41,739). The debts mature from 2019 to 2029.

Specific investment properties and golf courses with a carrying value of \$860,461 (2017 - \$708,720) and assignment of applicable rents and insurance proceeds have been pledged as collateral for the above debt. The weighted average effective interest rate for the above debts, based on year end balances, is 3.47% (2017 - 3.42%).

The minimum contractual principal payments due within each of the next five years and thereafter are as follows:

2019	61,604
2020	66,976
2021	73,381
2022	35,220
2023	75,429
Thereafter	144,844
	457,454

The change in debt on investment properties and golf course assets during the year is as follows:

	2018	2017
Balance - beginning of year	444,807	455,189
<b>Cash movements</b>		
Principal repayments		
Scheduled amortization on mortgages	(15,964)	(18,796)
Mortgage repayments	(51,909)	(23,076)
New mortgages	75,918	37,507
<b>Non-cash movements</b>		
Mortgage payable disposed through sale during the year (note 8)	(3,662)	(2,640)
Deferred financing fees capitalized	(627)	(195)
Amortization of deferred financing fees	341	548
Change in derivative fair value swap	254	(1,145)
Foreign currency translation included in OCI	5,184	(2,585)
Balance - end of year	454,342	444,807

### F. REIT - CONVERTIBLE DEBENTURES

On December 3, 2014, the REIT issued a 5.50% extendible convertible unsecured subordinated debenture ("REIT debenture") to the public for gross proceeds of \$34,500, including \$4,500 issued pursuant to the exercise of an over-allotment option. The REIT debenture bears interest at an annual rate of 5.50% payable semi-annually in arrears on June 30 and December 31 in each year commencing June 30, 2015. The maturity date of the REIT debenture is December 31, 2019. The REIT debenture can be converted into trust units at the holders' option at any point prior to the maturity date at a conversion price of \$12.65 per unit (the "Conversion Price"). On and from December 31, 2017, and prior to December 31, 2018, the REIT debenture may be redeemed by the REIT, in whole at any time, or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, provided that the volume weighted-average trading price of the trust units for a specified period (the "Current Market Price") preceding the date on which notice of redemption is given is not less than 125% of the Conversion Price. On and from December 31, 2018, and prior to the maturity date, the REIT debenture may be redeemed by the REIT, in whole at any time or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest. Subject to regulatory approval and other conditions, the REIT may, at its option, elect to satisfy its obligation to pay the principal amount of the REIT debenture on redemption or at maturity, in whole or in part, by delivering that number of freely tradeable trust units obtained by dividing the principal amount of the REIT debenture being repaid by 95% of the Current Market Price on the date of redemption or maturity. The issuance was qualified under a short form prospectus dated November 25, 2014.

On December 21, 2017, the REIT issued a 5.25% extendible convertible unsecured subordinated debentures (the "2017 Debentures") to the public for gross proceeds of \$23,000, including \$3,000 issued pursuant to the exercise of an over-allotment option. Transaction costs related to the issuance were \$1,457 for net proceeds of \$21,543. The 2017 Debentures bear interest at an annual rate of 5.25% payable semi-annually in arrears on June 30 and December 31 in each year commencing June 30, 2018. The maturity date of the 2017 Debentures is December 31, 2022. The 2017 Debentures can be converted into trust units at the holders' option at any point prior to the maturity date at a conversion rate of 86.9565 trust units per one thousand principal amount of convertible debentures (the "Conversion Price"). On and

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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from December 31, 2020, and prior to December 31, 2021, the 2017 Debentures may be redeemed by the REIT, in whole at any time, or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, provided that the volume weighted-average trading price of the trust units for a specified period (the "Current Market Price") preceding the date on which notice of redemption is given is not less than 125% of the Conversion Price. On and from December 31, 2021, and prior to the maturity date, the 2017 Debentures may be redeemed by the REIT, in whole at any time or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest. Subject to regulatory approval and other conditions, the REIT may, at its option, elect to satisfy its obligation to pay the principal amount of the convertible debenture on redemption or at maturity, in whole or in part, by delivering that number of freely tradeable trust units obtained by dividing the principal amount of the 2017 Debentures being repaid by 95% of the Current Market Price on the date of redemption or maturity.

The fair value of the host instruments component was calculated using a market interest rate for an equivalent non-convertible, non-extendible bond. The conversion feature components are separated and recognized at its fair value and presented as a liability.

A reconciliation of the convertible debentures is as follows:

	Host Instruments	Conversion Features	Total
Balance at December 31, 2016	32,749	61	32,810
Convertible debenture issued	22,205	795	23,000
Transaction costs	(1,457)	—	(1,457)
Amortization of discount and transaction costs	549	—	549
Fair value adjustment on conversion feature	—	(127)	(127)
Balance at December 31, 2017	54,046	729	54,775
Amortization of discount and transaction costs	971	—	971
Fair value adjustment on conversion feature	—	(542)	(542)
Balance at December 31, 2018	55,017	187	55,204

During the year ended December 31, 2018, we recognized \$3,100 of interest expense related to the convertible debentures which is included in finance costs (note 21) (2017 - \$1,931).

At December 31, 2018 we remeasured the conversion features to fair value resulting in a fair value gain of \$542 for the year (2017 - fair value gain of \$127). Supplemental information on fair value measurement, including valuation techniques and key inputs, is included in note 29.

### 17. SHARE CAPITAL

#### A. COMMON SHARES

2018		
	Number of Shares Issued (# of shares)	Amount (\$000s)
Common shares, beginning of the year	33,389,451	72,729
Share options exercised	14,200	217
Shares purchased for cancellation	(57,156)	(125)
Common shares, end of the year	33,346,495	72,821

2017		
	Number of Shares Issued (# of shares)	Amount (\$000s)
Common shares, beginning of the year	33,350,898	72,137
Share options exercised	38,553	592
Shares purchased for cancellation	—	—
Common shares, end of the year	33,389,451	72,729

Authorized:

- Unlimited common shares
- Unlimited common shares, non-voting
- Unlimited first preferred shares
- Unlimited first preferred shares, non-voting

We announced a Normal Course Issuer Bid (NCIB) on March 29, 2017 which expired March 30, 2018. Under this bid, we were allowed to purchase up to 1,667,704 common shares (approximately 5% of issued and outstanding) with a daily repurchase restriction of 2,158 common shares. No shares were purchased under this bid.

On March 29, 2018 we announced a new NCIB commencing March 31, 2018 and ending March 30, 2019. Under the bid, we may acquire up to 1,669,782 common shares in total (approximately 5% of our issued and outstanding common shares) with a daily repurchase restriction of 1,262 common shares.

During the year, there were 57,156 common shares purchased for cancellation by Melcor pursuant to the new NCIB at a cost of \$761 (2017 - \$nil common shares purchased for cancellation). As at December 31, 2018, 1,612,626 additional common shares may be repurchased by Melcor under the current NCIB.

#### B. STOCK-BASED COMPENSATION PLANS

On September 28, 2000, Melcor's Board of Directors approved a stock-based compensation plan (the "2000 Plan"). This plan was canceled effective May 10, 2018.

On February 23, 2007 Melcor's Board of Directors approved a stock-based compensation plan (the "2007 Plan"). Under the 2007 Plan, Melcor may grant options to full-time, salaried employees and designated contractors after one year of service. The 2007 Plan requires that the option price shall not be less than the weighted average trading price for the 20 consecutive days during which shares traded on the TSX immediately prior to the granting of the stock option. At the discretion of the board, the options vest over a period of three years and expire no longer than seven (7) years from the date of issuance. The 2007 Plan was approved by Melcor's shareholders at the Shareholders Annual Meeting in April 2007. Melcor has 1,792,000 shares reserved for issuance under the 2007 Plan (2017 - 1,616,013).

On May 10, 2018 Melcor's Board of Directors approved an amendment to the 2007 Plan that will allow participants to purchase common shares of Melcor and benefit from their appreciation through a cashless exercise option feature. The cashless exercise right allows for surrender of all or part of the option to Melcor in consideration of a payment of the in-the-money amount. Upon this exercise Melcor shall satisfy the payment of the in-the-money amount by delivering to the participant the net number of shares.

On May 10, 2018 shareholders of Melcor approved the grant of Restricted Share Units (RSUs). Each RSU will give the participant

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the right to receive, upon the vesting date, the payout amount with respect to the RSUs which have vested. Payout shall be satisfied by issuing or transferring to the participant one common share for each RSU vested. Except as otherwise provided by the RSU plan, the number of RSUs subject to each grant, how the payout amount is satisfied and other terms and conditions relating to each such RSU shall be determined by Melcor's Board of Directors. When dividends are paid by Melcor, each holder of an RSU shall be entitled to additional RSUs (each a "Dividend Restricted Share Unit") equal to (a) the product of the aggregate number or RSUs held by the participant on record for such dividend multiplied by the per common share amount of such dividend divided by (b) the fair market value of a common share calculated as of the date on which the dividend is paid. Restricted share units granted shall vest and become available for redemption between 34 and 36 months from the grant date, the vesting date shall be set forth in the grant agreement. Melcor's Board of Directors may establish additional performance criteria which may be a condition precedent to the vesting of any RSU, performance criteria will be set forth in the grant agreement.

The introduction of the RSU plan and the amendment to the 2007 Plan increased the total number of common shares cumulatively reserved for issuance under either plan, when combined with common shares reserved for issuance to a maximum of 3,300,000.

### C. STOCK OPTIONS OUTSTANDING AND AVAILABLE FOR GRANTING UNDER THE 2007 PLAN

	2018	2017
Stock options available, beginning of the year	637,566	854,666
Stock option plan amendment	190,187	—
Stock options granted	(220,500)	(276,300)
Stock options expired / canceled	144,100	59,200
Stock options available, end of the year	751,353	637,566

2018		
	Number of Options	Weighted Average Exercise Price
Stock options outstanding, beginning of the year	978,447	16.00
Stock options granted to employees	220,500	9.96
Stock options exercised	(14,200)	13.62
Stock options expired / canceled	(144,100)	18.98
Stock options outstanding, end of the year	1,040,647	14.08

2017		
	Number of Options	Weighted Average Exercise Price
Stock options outstanding, beginning of the year	799,900	16.44
Stock options granted to employees	276,300	14.94
Stock options exercised	(38,553)	13.73
Stock options expired / canceled	(59,200)	18.43
Stock options outstanding, end of the year	978,447	16.00

The weighted average share price at the date of exercise was \$15.24 (2017 - \$14.99).

### D. UNITS AVAILABLE FOR GRANTING UNDER THE RSU PLAN

2018	
	Number of Units
RSUs outstanding, beginning of the year	—
Implementation of the RSU plan	1,500,000
RSUs granted to employees	(67,400)
RSUs outstanding, end of the year	1,432,600

### E. STOCK OPTIONS OUTSTANDING AND EXERCISABLE UNDER THE 2007 PLAN

2018			
Stock Option Expiry Date	Outstanding Stock Options (#)	Exercise Price Per Share (\$)	Stock Options Exercisable
December 19, 2019	158,700	21.35	158,700
December 21, 2020	158,747	14.05	158,747
December 13, 2021	229,900	13.21	148,000
December 12, 2022	272,800	14.94	91,400
December 12, 2023	220,500	13.01	—
	1,040,647		556,847

### F. RESTRICTED SHARE UNITS OUTSTANDING AND REDEEMABLE

2018			
Restricted Share Unit Expiry Date	Outstanding RSUs Options (#)	Exercise Price Per Unit (\$)	RSUs Vested
December 31, 2021	67,400	13.01	—
	67,400		—

### G. STOCK BASED COMPENSATION EXPENSE

The following assumptions were used in the Black-Scholes option pricing model for options granted. Expected volatility was based on historical volatility.

#### i) 2007 Option Plan

	2018	2017
Expected volatility	23%	25%
Risk-free interest rate	2.05%	1.61%
Annual dividend rate	4.00%	3.49%
Expected life of options in years	3.86	3.86

The weighted average fair value of stock options granted during the year was \$1.62 (2017 - \$2.21) per stock option. Current year vesting of options resulted in a \$433 (2017 - \$408) charge to stock based compensation expense and corresponding credit to contributed surplus.

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### ii) RSU Plan

The weighted average fair value of RSUs granted during the year was \$13.01 (2017 - n/a) per RSU. Current year compensation expense related to the RSU plan resulted in a \$17 (2017 - \$nil) charge to stock based compensation expense and corresponding credit to contributed surplus.

## 18. PER SHARE AMOUNTS

(# of shares)	2018	2017
Basic weighted average common shares outstanding during the year	33,393,743	33,361,144
Dilutive effect of options and restricted share units	—	19,884
Diluted weighted average common shares	33,393,743	33,381,028

For the year ended December 31, 2018, there were 1,040,647 stock options excluded from the calculation of diluted earnings per share (2017 - 570,400) as their impact would be anti-dilutive.

Diluted earnings per share was calculated based on the following:

	2018	2017
Profit attributable to shareholders	64,273	38,525
Profit for computation of diluted earnings per share	64,273	38,525

## 19. ACCUMULATED OTHER COMPREHENSIVE INCOME

	2018	2017
Balance, beginning of the year	16,948	25,190
Other comprehensive income (loss) net of tax	12,181	(8,242)
Balance, end of the year	29,129	16,948

The other comprehensive income represents the net unrealized foreign currency translation gain on our net investment in our foreign operations.

## 20. COMMITMENTS AND CONTINGENCIES

In the normal course of operations, we issue letters of credit as collateral for the completion of obligations pursuant to development agreements signed with municipalities. As at December 31, 2018 we had \$31,784 (December 31, 2017 - \$40,256) in letters of credit outstanding and recorded a net liability of \$77,658 (December 31, 2017 - \$87,139) in provision for land development costs in respect of these development agreements.

Normally, obligations collateralized by the letters of credit diminish as the developments proceed, through a series of staged reductions over a period of years (average of three to four years) and are ultimately extinguished when the municipality has issued final completion certificates.

We enter into joint arrangements and, in doing so, may take on risk beyond our proportionate interest in the joint arrangement. These situations generally arise where preferred financing terms can be arranged on the condition that the strength of our company's covenant will backstop that of the other joint arrangement participant(s) who also provide similar guarantees. We will have to

perform on our guarantee only if a joint arrangement participant was in default of their guarantee. At December 31, 2018 we had guaranteed \$9,171 (December 31, 2017 - \$10,051) in credit facilities in excess of the amount recognized as a liability. We also guaranteed \$12,512 (December 31, 2017 - \$12,534) in excess of our share of letters of credit posted with the municipalities.

The loan guarantees include those which are ongoing, as they relate to the relevant lines of credit, and those which have staged reductions as they relate to the financing of specific assets or projects such as infrastructure loans, short-term land loans or mortgages.

To mitigate the possibility of financial loss, we are diligent in our selection of joint arrangement participants. As well, we have remedies available within the joint arrangement agreement, to address the application of the guarantees. In certain instances there are reciprocal guarantees amongst joint arrangement participants.

We also enter into lease agreements with tenants which specify tenant incentive payments upon completion of the related tenant improvements. Incentive payments of approximately \$1,599 (2017 - \$440) may be required from lease agreements entered during the year.

## 21. FINANCE COSTS

	2018	2017
Interest on Melcor - revolving credit facilities	3,108	2,549
Interest on REIT - revolving credit facility	225	776
Interest on REIT convertible debenture	3,100	1,931
Interest on general debt	19,649	18,959
Financing costs and bank charges	1,225	1,284
Gain on debt settlement	—	(690)
Non cash financing costs	1,466	414
	28,773	25,223
Less: capitalized interest	(4,205)	(3,811)
	24,568	21,412

Cumulative interest capitalized on land inventory at the end of the year is \$43,256 (2017 - \$41,279). Finance costs paid during the year was \$27,174 (2017 - \$24,956).

## 22. REVENUE AND EXPENSE BY NATURE

### A. REVENUE

The components of revenue are as follows:

Revenue from contracts with customers	2018	2017
Sale of land	162,257	153,234
Operating cost recoveries	17,847	17,891
Golf course revenue	7,543	7,784
Total	187,647	178,909
Other revenue	2018	2017
Lease revenue	75,642	74,758
Management fees	4,145	4,283
Total	79,787	79,041
Total Revenue	267,434	257,950

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The timing of recognition for revenue from contracts with customers is as follows:

	2018				
	Community Development	Investment Property	Recreational Properties	REIT	Total
Timing of Revenue Recognition					
At a point in time	162,257	—	6,807	—	169,064
Over time	—	5,055	736	12,792	18,583
Revenue from contracts with customers	162,257	5,055	7,543	12,792	187,647

	2017				
	Community Development	Investment Property	Recreational Properties	REIT	Total
Timing of Revenue Recognition					
At a point in time	153,234	—	6,950	—	160,184
Over time	—	4,820	834	13,071	18,725
Revenue from contracts with customers	153,234	4,820	7,784	13,071	178,909

### B. COST OF SALES

The components of cost of sales are as follows:

	2018	2017
Cost of land sold	97,695	97,588
Investment property direct operating expenses	38,933	38,044
Direct golf course expenses	4,631	4,514
Golf course asset depreciation	964	996
Total	142,223	141,142

### C. GENERAL AND ADMINISTRATIVE EXPENSE

The components of general and administrative expenses are as follows:

	2018	2017
Employee salary and benefits		
Salaries, wages and retirement allowance	11,451	12,964
Employee benefits	923	813
Stock based compensation	450	408
Corporate asset depreciation	453	440
Marketing	1,484	1,806
Other	8,668	8,922
Total	23,429	25,353

Included in employee salary and benefits is the compensation of key management. Key management includes our directors and members of the executive management team. Compensation awarded to key management includes:

	2018	2017
Salaries, wages and retirement allowance	2,837	4,690
Employee benefits	45	47
Stock based compensation	247	238
Total	3,129	4,975

### D. FAIR VALUE ADJUSTMENT ON INVESTMENT PROPERTIES

The components of the fair value adjustment are as follows:

	2018	2017
Land transferred to investment properties	1,015	342
Property under development	7,356	3,310
Commercial and residential properties	(7,508)	(12,480)
Total	863	(8,828)

## 23. INCOME TAX

Components of tax expense:

	2018	2017
Current tax expense		
Current year	22,245	11,559
Adjustment to prior years	216	1,036
	22,461	12,595
Deferred tax expense		
Origination and reversal of temporary differences	(3,482)	3,613
Change in tax rates	(11)	(1,048)
	(3,493)	2,565
Total tax expense	18,968	15,160

Reconciliation of effective tax rate:

	2018	2017
Income before taxes	83,241	53,685
Statutory rate	27%	27%
	22,475	14,495
Taxable (non-taxable) portion of capital gains, fair value adjustments and recovery on REIT transfer	(664)	932
Non-taxable portion of REIT income	(1,524)	(1,324)
Impact of different tax rates in US subsidiary	(138)	(343)
Non-deductible expenses	2,563	2,297
Non-taxable fair value adjustments on REIT units	(3,733)	151
Change in tax rates	(11)	(1,048)
Total tax expense	18,968	15,160

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Movement in deferred tax balances during the year:

	2018			
	Opening	Recognized in profit or loss	Recognized in OCI	Closing
Investment property and capital assets	60,576	(846)	204	59,934
Reserves for tax purposes	12,671	(1,342)	—	11,329
Capitalized interest	(3,357)	(1,356)	(44)	(4,757)
Provision for decommissioning obligation	(233)	7	—	(226)
Convertible debenture	169	44	—	213
Deferred tax liability	69,826	(3,493)	160	66,493

	2017			
	Opening	Recognized in profit or loss	Recognized in OCI	Closing
Investment property and capital assets	59,430	1,343	(197)	60,576
Reserves for tax purposes	11,356	1,315	—	12,671
Capitalized interest	(3,215)	(142)	—	(3,357)
Provision for decommissioning obligation	(223)	(10)	—	(233)
Convertible debenture	110	59	—	169
Deferred tax liability	67,458	2,565	(197)	69,826

No deferred tax liability has been recognized in respect of the net unrealized foreign currency exchange gain in accumulated other comprehensive income. Income tax paid during the year was \$6,022 (2017 - \$21,672).

### 24. JOINT ARRANGEMENTS

The table below discloses our proportionate share of the assets, liabilities, revenue, and earnings of 29 arrangements (2017 – 30) that are recorded in these financial statements as follows:

Joint Venture	Interest	Principle activity	Country of incorporation
Anders East Developments	33%	Active land development with investment property	Canada
Anders East Two Communities	50%	Non-active land development	Canada
Blackmud Communities	39%	Active land development	Canada
Capilano Investments	50%	Investment property	Canada
Chestermere Communities	50%	Active land development with investment property	Canada
Country Hills Communities	50%	Active land development	Canada
Highview Communities	60%	Active land development	Canada
HV Nine Joint Venture	7%	Active land development	Canada
Jagare Ridge Communities	50%	Active land development and recreational property	Canada
Jesperdale Communities	50%	Active land development	Canada
Kimcor Communities	50%	Active land development	Canada
Kinwood Communities	50%	Active land development	Canada

Joint Venture	Interest	Principle activity	Country of incorporation
Lakeside Communities	50%	Non-active land development	Canada
Larix Communities	50%	Active land development	Canada
Lewis Estates Communities	60%	Active land development and recreational property	Canada
Mattson North Communities	50%	Active land development	Canada
MMY Properties	33%	Investment property	Canada
Rosenthal Communities	50%	Active land development	Canada
South Shepard Communities	50%	Non-active land development	Canada
Stonecreek Shopping Centre	30%	Investment property	Canada
Sunset Properties	60%	Active land development	Canada
Terwillegar Pointe Communities	50%	Non-active land development	Canada
Watergrove Developments	50%	Manufactured home community	Canada
Westmere Properties	50%	Investment property	Canada
Whitecap Communities	50%	Active land development	Canada
Windermere Communities	50%	Active land development	Canada
Windermere at Glenridding Communities	35%	Active land development	Canada
Winterburn Developments	50%	Active land development	Canada
Villeneuve Communities	60%	Active land development	Canada

The following summarizes financial information about our share of assets, liabilities, revenue and earnings of our interest in joint arrangements that are recorded in our accounts for the year ended December 31, 2018.

	2018	2017
Assets	455,808	444,378
Liabilities	169,308	169,740
Revenue	82,811	82,046
Net Earnings	27,126	22,280

Contingent liabilities arising for liabilities of other joint arrangement participants are disclosed in note 20.

### 25. SEGMENTED INFORMATION

In the following schedules, segment earnings has been calculated for each segment by deducting from revenues of the segment all direct costs and administrative expenses which can be specifically attributed to the segment, as this is the basis for measurement of segment performance. Common costs, which have not been allocated, include finance costs, foreign exchange gains, adjustments to REIT units and income tax expense.

The allocation of these costs on an arbitrary basis to the segments would not assist in the evaluation of the segments' contributions. Inter-segment transactions are entered into under terms and conditions similar to those with unrelated third parties.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in \$000s except per share and acre amounts)

### Community Development

This division is responsible for purchasing and developing land to be sold as residential, industrial and commercial lots.

### Property Development

This division develops high-quality retail, office and industrial revenue-producing properties on serviced commercial sites developed primarily from our community development division. Once substantial completion of construction and leasing are complete, these properties are transferred to our investment property division at fair value (refer to note 11).

### Investment Property

This division owns 21 leasable commercial, retail and residential properties (2017 – 25 properties) and other rental income producing assets such as parking lots and land leases.

### REIT

This division owns 37 leasable commercial and retail properties (2017 – 37 properties) and other rental income producing assets such as residential property, parking lots and land leases.

### Recreation Property

This division owns and manages three 18-hole golf course operations (one of which is 60% owned), and has a 50% ownership interest in one 18-hole golf course.

### US Operations

Melcor has a wholly owned subsidiary with operations in the US, which includes a Community Development division and an Investment Property division. The subsidiary's related balances are below.

A reconciliation of our revenues and assets by geographic location is as follows:

	External Revenue		Total Assets at December 31	
	2018	2017	2018	2017
United States	46,322	24,297	272,537	203,687
Canada	221,112	233,653	1,750,539	1,787,296
Total	267,434	257,950	2,023,076	1,990,983

2018	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue (note 22)	168,336	30,751	32,545	70,173	8,391	—	310,196	(42,762)	267,434
Cost of sales (note 22)	(99,765)	(30,350)	(13,236)	(28,097)	(6,013)	—	(177,461)	35,238	(142,223)
Gross profit	68,571	401	19,309	42,076	2,378	—	132,735	(7,524)	125,211
General and administrative expense (note 22)	(9,501)	(2,406)	(2,439)	(2,884)	(2,298)	(6,980)	(26,508)	3,079	(23,429)
Fair value adjustment on investment properties (note 11, 22 and 29)	—	7,356	447	(11,385)	—	—	(3,582)	4,445	863
Gain (loss) on sale of assets	—	—	—	—	14	(8)	6	—	6
Interest income	905	27	8	137	—	214	1,291	—	1,291
Segment Earnings (loss)	59,975	5,378	17,325	27,944	94	(6,774)	103,942	—	103,942
Foreign exchange gain									429
Finance costs (note 21)									(24,568)
Adjustments related to REIT units (note 26)									3,438
Income before income taxes									83,241
Income tax expense (note 23)									(18,968)
Net income for the year									64,273

2017	Community Development	Property Development	Investment Properties	REIT	Recreational Properties	Corporate	Subtotal	Intersegment Elimination	Total
Revenue (note 22)	158,285	11,015	34,792	66,613	8,650	—	279,355	(21,405)	257,950
Cost of sales (note 22)	(99,114)	(10,700)	(13,876)	(26,500)	(5,889)	—	(156,079)	14,937	(141,142)
Gross profit	59,171	315	20,916	40,113	2,761	—	123,276	(6,468)	116,808
General and administrative expense (note 22)	(8,908)	(2,065)	(3,197)	(2,718)	(2,183)	(9,418)	(28,489)	3,136	(25,353)
Fair value adjustment on investment properties (note 11, 22 and 29)	—	3,308	(2,668)	(12,800)	—	—	(12,160)	3,332	(8,828)
Gain (loss) on sale of assets	—	—	—	—	35	(18)	17	—	17
Interest income	906	16	33	62	—	112	1,129	—	1,129
Segment Earnings (loss)	51,169	1,574	15,084	24,657	613	(9,324)	83,773	—	83,773
Foreign exchange loss									(591)
Finance costs (note 21)									(21,412)
Adjustments related to REIT units (note 26)									(8,085)
Income before income taxes									53,685
Income tax expense (note 23)									(15,160)
Net income for the year									38,525

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in \$000s except per share and acre amounts)

### 26. NON-CONTROLLING INTEREST IN MELCOR REIT

In accordance with our policy, as detailed in notes 3R and 29, we account for the 47.0% publicly held interest in the REIT as a financial liability measured at fair value through profit or loss ("FVTPL"). As at December 31, 2018 the REIT units had a fair value of \$98,374 (2017 - \$94,898). We recorded adjustments related to REIT units for the year of \$3,438 (2017 - \$8,085).

On January 12, 2018 the REIT completed the issuance of 2,035,500 trust units in exchange for subscription receipts previously issued and outstanding as of December 31, 2017. Subscription receipts had been issued at \$8.50 for gross proceeds of \$17,302, including \$2,257 issued pursuant to the exercise of an over-allotment option. The funds were used to help the REIT finalize a purchase of five commercial properties from Melcor for a total sales price of \$80,875 ("Melcor Acquisition"). The sales price was settled through the REIT's assumption of \$31,038 in mortgages payable; issuance of 1,331,167 Class C LP units, representing \$13,312 in Retained Debt by Melcor; issuance of 283,447 Class B LP Units at a price of \$8.82, representing \$2,500; and cash of \$34,025. The transaction costs directly related to the unit issuance were \$1,488 and are included in income as part of adjustments related to REIT units. As at December 31, 2018 Melcor owns 53.0% interest in the REIT through ownership of Class B LP Units. We have assessed and concluded that Melcor continues to retain control of the REIT in accordance with IFRS 10, Consolidated Financial Statements.

A reconciliation of the subscription receipts is as follows:

	Amount
Gross proceeds	17,302
Accrued interest payable for distribution	114
Transaction costs	(793)
	<b>16,623</b>

As illustrated in the table below, the adjustment is comprised of:

	2018	2017
Fair value adjustment on REIT units	<b>13,827</b>	(558)
Distributions to REIT unitholders	<b>(8,901)</b>	(7,527)
Transaction costs on REIT unit issuance		
Capitalized against REIT trust units	<b>(1,190)</b>	—
Capitalized to investment properties	<b>(298)</b>	—
Adjustments related to REIT units	<b>3,438</b>	(8,085)

The following tables summarize the financial information relating to Melcor's subsidiary, the REIT, that has material non-controlling interest (NCI), before intra-group eliminations (presented at 100%).

	2018	2017
Assets	<b>709,603</b>	676,237
Liabilities	<b>400,094</b>	378,405
Net assets	<b>309,509</b>	297,832
Cost of NCI	<b>103,959</b>	103,959
Fair value of NCI	<b>98,374</b>	94,898

	2018	2017
Revenue	<b>70,173</b>	66,613
Net income and comprehensive income	<b>17,610</b>	732
Cash flows from operating activities	<b>11,870</b>	13,605
Cash flows (used in) from investing activities	<b>(26,700)</b>	1,905
Cash flows from financing activities, before distributions to REIT unitholders	<b>13,011</b>	2,576
Cash flows used in financing activities - cash distributions to REIT unitholders	<b>(8,789)</b>	(7,527)
Net (decrease) increase in cash and cash equivalents	<b>(10,608)</b>	10,559

### 27. MANAGEMENT OF CAPITAL RESOURCES

We define capital as share capital, contributed surplus, accumulated other comprehensive income, retained earnings and general debt. Our objective when managing capital is to utilize debt to improve our performance, support the growth of our assets, and finance capital requirements arising from the cyclical nature of our business. Specifically, we plan to utilize shorter term debt for financing infrastructure, land inventory, receivables and development activities and to utilize longer term debt and equity for the purchase of property and land assets.

We manage the capital structure through adjusting the amount of long-term debt, credit facilities, the amount of dividends paid, and through normal course issuer bids.

There were no changes to the way we define capital, our objectives, and our policies and processes for managing capital from the prior fiscal period.

We are subject to financial covenants on our \$120,000 (2017 - \$120,000) Melcor revolving credit facility. The covenants include a maximum debt to total capital ratio of 1.25, a minimum interest coverage ratio of 3.00, and a minimum net book value of shareholders' equity of \$300,000. As at December 31, 2018, and throughout the period, we were in compliance with our financial covenants.

In addition, we are subject to financial covenants on our \$35,000 REIT revolving credit facility. The covenants include a maximum debt to total capital ratio of 60% (excluding convertible debentures), a minimum debt service coverage ratio of 1.50, and a minimum adjusted unitholders' equity of \$140,000. As at December 31, 2018, and throughout the period, the REIT was in compliance with its financial covenants.

We also have financial covenants on certain mortgages for investment properties. At December 31, 2018, and throughout the period, we were in compliance with our financial covenants on our mortgages. We prepare financial forecasts to monitor the changes in our debt and capital levels and our ability to meet our financial covenants.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in \$000s except per share and acre amounts)

### 28. RISK MANAGEMENT

We are exposed to the following risks as a result of holding financial instruments:

#### A. CREDIT RISK

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Our financial assets that are exposed to credit risk consist of cash and cash equivalents, restricted cash, accounts receivable, and agreements receivable. Our maximum exposure to credit risk is the carrying amount of these instruments.

We invest our cash in bank accounts and short-term deposits with a major Canadian chartered bank. Accounts receivable balances include amounts due from other joint arrangement participants for their portion of management fees due to us as well as other various smaller balances due from municipal governments, other developers and tenants.

We manage our credit risk in the Investment Property and REIT Divisions through careful selection of tenants and look to obtain national tenants or tenants in businesses with a long standing history, or perform financial background checks including business plan reviews for smaller tenants. We manage our concentration risk in the Investment Property Division by renting to an expansive tenant base, with no dependency on rents from any one specific tenant.

Accounts receivables are significantly low risk due to their individual immaterial balances, the nature of the party they are due from (including joint venture participants under management by Melcor), and the overall lack of historical write offs. No lifetime expected losses are considered necessary.

Agreements receivable are collateralized by specific real estate sold. Agreements receivable relate primarily to land sales in Alberta and, accordingly, collection risk is related to the economic conditions of that region. We manage credit risk by selling to certain qualified registered builders. Concentration risk is low as we sell to a large builder base, and no receivables are concentrated to one specific builder and Melcor maintains an approved builder list containing those builders which have a long standing track record, good volumes, positive perception in the industry, and strong history of repayment. At December 31, 2018, 89% of agreements receivable are due from approved builders (2017 - 93%).

	Current	0-6 months past due	Greater than 6 months past due	Total
<b>As at December 31, 2018</b>				
Expected loss rate	0.06%	0.18%	0.18%	
Agreements receivable	125,274	948	346	126,568
Loss allowance	75	2	1	78

Total loans included in agreements receivable that would have otherwise been past due at December 31, 2018, but whose terms have been renegotiated is \$9,019 (2017 - \$1,821). In order to address current market conditions, we have provided extensions on our standard terms to relieve liquidity pressure on builders. At December 31, 2018, we have identified \$1,216 (2017 - \$2,866) in agreements receivable which are in arrears.

#### B. LIQUIDITY RISK

Liquidity risk is the risk that we will not be able to meet our financial obligations as they fall due. We manage liquidity risk to ensure that we have sufficient liquid financial resources to finance operations and meet long-term debt repayments. We monitor rolling forecasts of our liquidity, which includes cash and cash equivalents and the undrawn portion of the operating loan, on the basis of expected cash flows. In addition, we monitor balance sheet liquidity ratios against loan covenant requirements and maintain ongoing debt financing plans. We believe that we have access to sufficient capital through internally generated cash flows, external sources and undrawn committed borrowing facilities to meet current spending forecasts.

Refer to note 16 for the maturity analysis of general debt and details on the bank indebtedness. Accounts payable and accrued liabilities are expected to be repaid in the next twelve months.

#### C. MARKET RISK

We are subject to interest rate cash flow risk as our operating credit facilities and certain of our general debt bear interest at rates that vary in accordance with prime borrowing rates in Canada. For each 1% change in the rate of interest on loans subject to floating rates, the change in annual interest expense is approximately \$1,691 (2017 - \$1,551) based upon applicable year end debt balances. We are not subject to other significant market risks pertaining to our financial instruments.

### 29. FAIR VALUE MEASUREMENT

Fair value is the price that market participants would be willing to pay for an asset or liability in an orderly transaction under current market conditions at the measurement date.

The fair value of Melcor's financial instruments were determined as follows:

- the carrying amounts of cash and cash equivalents, restricted cash, accounts receivable, agreements receivable and accounts payable and accrued liabilities approximate their fair values based on the short term maturities of these financial instruments.
- fair values of general debt and derivative financial liabilities - interest rate swaps are estimated by discounting the future cash flows associated with the debt at market interest rates (Level 2).
- fair value of derivative financial liabilities - conversion features on the REIT's convertible debentures are estimated based upon unobservable inputs, including volatility and credit spread (Level 3).
- fair value of REIT units are estimated based on the closing trading price of the REIT's trust units (Level 1).

In addition, Melcor carries its investment properties at fair value, as detailed in note 3F, which is determined based on the accepted valuation methods of direct income capitalization or discounted future cash flows (Level 3).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in \$000s except per share and acre amounts)

The following table summarizes Melcor's assets and liabilities carried at fair value and its financial assets and liabilities where carrying value does not approximate fair value.

2018					
	Fair Value hierarchy	Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value
<b>Non-financial assets</b>					
Investment properties	Level 3	1,032,687	—	1,032,687	1,032,687
Asset held for sale	Level 3	—	—	—	—
<b>Financial liabilities</b>					
General debt, excluding derivative financial liability	Level 3	—	604,352	604,352	589,890
REIT - Convertible debenture	Level 2	—	55,017	55,017	56,738
Liability held for sale	Level 3	—	—	—	—
<b>Derivative financial liabilities</b>					
Interest rate swaps	Level 3	(803)	—	(803)	(803)
Conversion features on convertible debentures	Level 3	187	—	187	187
REIT units	Level 1	98,374	—	98,374	98,374

2017					
	Fair Value hierarchy	Fair Value	Amortized Cost	Total Carrying Value	Total Fair Value
<b>Non-financial assets</b>					
Investment properties	Level 3	975,856	—	975,856	975,856
Asset held for sale	Level 3	6,732	—	6,732	6,732
<b>Financial liabilities</b>					
General debt, excluding derivative financial liability	Level 3	—	603,483	603,483	576,920
REIT - Convertible debenture	Level 2	—	54,046	54,046	57,289
Liability held for sale	Level 3	—	3,670	3,670	3,670
<b>Derivative financial liabilities</b>					
Interest rate swaps	Level 3	(1,057)	—	(1,057)	(1,057)
Conversion features on convertible debentures	Level 3	729	—	729	729
REIT units	Level 1	94,898	—	94,898	94,898

The prior table analyzes assets and liabilities carried at fair value in the consolidated statement of financial position, by the levels in the fair value hierarchy. The fair value hierarchy categorizes fair value measurement into three levels based upon the inputs to the valuation technique, which are defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that are accessible at the measurement date.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: unobservable inputs for the asset or liability.

There were no transfers between the levels of the fair value hierarchy during the year.

### INVESTMENT PROPERTIES

Investment properties are remeasured to fair value on a recurring basis, determined based on the accepted valuation methods of direct income capitalization or discounted future cash flows. The application of these valuation methods results in these measurements being classified as Level 3 in the fair value hierarchy.

Under the discounted future cash flows method, fair values are determined by discounting the forecasted future cash flows over ten years plus a terminal value determined by applying a terminal capitalization rate to forecasted year eleven cash flows.

Under the direct income capitalization method, fair values are determined by dividing the stabilized net operating income of the property by a property specific capitalization rate.

The significant unobservable inputs in the Level 3 valuations are as follows:

- Capitalization rate - based on actual location, size and quality of the property and taking into consideration available market data as at the valuation date;
- Stabilized net operating income - revenue less direct operating expenses adjusted for items such as average lease up costs, vacancies, non-recoverable capital expenditures, management fees, straight-line rents and other non-recurring items. For properties under development forecasted net operating income is based on location, type and quality of the property, supported by the terms of actual or anticipated future leasing
- Discount rate - reflecting current market assessments of the uncertainty in the amount and timing of cash flows;
- Terminal capitalization rate - taking into account assumptions regarding vacancy rates and market rents;
- Estimated costs to complete for properties under development - based on expected completion dates considering development and leasing risks specific to each property and the status of approvals and/or permits; and
- Cash flows - based on the physical location, type and quality of the property and supported by the terms of existing leases, other contracts or external evidence such as current market rents for similar properties.

An increase in the cash flows or stabilized net operating income results in an increase in fair value of investment property whereas an increase in the capitalization rate, discount rate or terminal capitalization rate decreases the fair value of the investment property.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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In determining the fair value of our investment properties judgment is required in assessing the 'highest and best use' as required under IFRS 13, Fair value measurement. We have determined that the current uses of our investment properties are their 'highest and best use'.

Melcor's executive management team is responsible for determining fair value measurements on a quarterly basis, including verifying all major inputs included in the valuation and reviewing the results. Melcor's management, along with the Audit Committee, discuss the valuation process and key inputs on a quarterly basis. At least once every two years, the valuations are performed by qualified external valuers who hold recognized and relevant professional qualifications and have recent experience in the location and category of the investment property being valued.

Investment properties were valued by Melcor's internal valuation team as at December 31, 2018 of which 32 investment properties (of 82 legal phases valued) with a fair value of \$420,145 were valued by qualified independent external valuation professionals during the year which resulted in fair value gains of \$863 recorded as fair value adjustment on investment properties in the statements of income and comprehensive income (2017 - investment properties were valued by Melcor Development Ltd.'s internal valuation team of which 48 investment properties (of 81 legal phases valued) with a fair value of \$688,267 were valued by qualified independent external valuation professionals during the year which resulted in fair value losses of \$8,828).

The following table summarizes the valuation approach, significant unobservable inputs, and the relationship between the inputs and the fair value:

Asset	Valuation approach	Significant observable inputs	Relationship between inputs and fair value
Investment properties	Direct capitalization or discounted cash flows	- Capitalization rate - Discount rate - Terminal rate - Stabilized NOI - Cash flows	Inverse relationship between capitalization, discount and terminal rates and fair value (higher rates result in decreased fair value); whereas higher stabilized NOI or cash flows results in increased fair value.
Properties under development	Direct capitalization less cost to complete	- Capitalization rate - Stabilized NOI - Costs to complete	Inverse relationship between capitalization rate and fair value (higher capitalization rate results in lower fair value); whereas higher stabilized NOI results in increased fair value.
Properties under development - undeveloped land	Direct comparison	Comparison to market transaction for similar assets	Land value reflects market value.

Weighted average stabilized net operating income for investment properties is \$1,506 (2017 - \$1,484). Other significant valuation metrics and unobservable inputs are set out in the following table. Fair values are most sensitive to changes in capitalization rates.

December 31, 2018	Investment Properties			Properties under Development		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	10.50%	6.66%	6.00%	6.50%	6.23%
Terminal capitalization rate	5.75%	9.00%	6.76%	6.25%	6.25%	6.25%
Discount rate	6.50%	9.75%	7.66%	7.00%	7.00%	7.00%

December 31, 2017	Investment Properties			Properties under Development		
	Min	Max	Weighted Average	Min	Max	Weighted Average
Capitalization rate	5.50%	8.75%	6.60%	5.75%	6.50%	6.07%
Terminal capitalization rate	5.75%	9.00%	6.75%	6.00%	6.25%	6.07%
Discount rate	6.00%	9.75%	7.67%	6.75%	7.00%	6.93%

An increase in the capitalization rates by 50 basis points would decrease the carrying amount of investment properties by \$56,215 (2017 - \$56,320). A decrease in the capitalization rates by 50 basis points would increase the carrying amount of investment properties by \$65,343 (2017 - \$65,115).

### GENERAL DEBT, EXCLUDING DERIVATIVE FINANCIAL LIABILITIES

The fair value of revolving credit facilities approximates the carrying value excluding unamortized financing costs. The facilities bear interest, at our option, at a rate per annum equal to either the bank's prime lending rate plus 0.75% to 2.25% or at the bank's then prevailing banker's acceptance rate plus a stamping fee of 2.25% to 3.00%.

The fair value of project specific financing, secured vendor take back debt on land inventory and debt on investment properties and golf course assets have been calculated by discounting the expected cash flows of each loan using a discount rate specific to each individual loan. The discount rate is determined using the bond yield for similar instruments of similar maturity adjusted for each individual project's specific credit risk. In determining the adjustment for credit risk, we consider current market conditions and other indicators of credit worthiness.

### REIT UNITS

REIT units are remeasured to fair value on a recurring basis and categorized as Level 1 in the fair value hierarchy. The units are fair valued based on the trading price of the REIT units at the period end date. At December 31, 2018 the fair value of the REIT units was \$98,374 (2017 - \$94,898). During the year a fair value gain of \$13,827 (2017 - loss of \$558) was recognized in the statement of income and comprehensive income, and was included in adjustments related to REIT units.

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### DERIVATIVE FINANCIAL LIABILITIES

Our derivative financial liabilities are comprised of floating for fixed interest rate swaps on mortgages (level 2) and the conversion features on our convertible debentures (level 3).

The fair value of the interest rate swaps are calculated as the net present value of the future cash flows expected to arise on the variable and fixed portion, determined using applicable yield curves at the measurement date. As at December 31, 2018 the fair value of interest rate swap contracts was \$803 (2017 - \$1,057).

The conversion features on the convertible debentures was valued by qualified independent external valuation professionals at December 31, 2018. This resulted in a fair value gain of \$542 (2017 - fair value gain of \$127) being recognized in income. The significant unobservable inputs used in the fair value measurement of the conversion features on the REIT convertible debentures as at December 31, 2018 are as follows:

- Volatility - expected volatility as at December 31, 2018 was derived from the historical prices of the REIT's trust units. As the REIT was formed on May 1, 2013, we have used the entire historical data up until December 31, 2018. Volatility was 17.80% (2017 - 21.70%).
- Credit spread - the credit spread of the convertible debentures was imputed from the traded price of the convertible debentures as at December 31, 2018. The credit spread used was 3.92% (2017 - 2.81%).

### 30. SUBSEQUENT EVENTS

#### DISTRIBUTIONS ON REIT TRUST UNITS:

On January 15, 2019 we declared a distribution of \$0.05625 per unit for the months of January, February and March 2019. The distributions will be payable as follows:

Month	Record Date	Distribution Date	Distribution Amount
January 2019	January 31, 2019	February 15, 2019	\$0.05625 per unit
February 2019	February 28, 2019	March 15, 2019	\$0.05625 per unit
March 2019	March 29, 2019	April 15, 2019	\$0.05625 per unit

#### DIVIDEND DECLARED:

On March 13, 2019, our board of directors declared a quarterly dividend of \$0.13 per share payable on March 29, 2019 to shareholders of record on March 22, 2019.